DOCUMENT RESUME

ED 238 375 HE 016 915

AUTHOR	Pocock, John W.
TITLE	Finance Committee. AGB Standing Committee Series [No. 3].
INSTITUTION	Association of Governing Boards of Universities and Colleges, Washington, D.C.
PUB DATE	[83]
NOTE	20p.
AVAILABLE FROM	Association of Governing Boards of Universities and Colleges, One Dupont Circle, Suite 400, Washington, DC 20036 ($3.50, nonmembers; $1.95, members).
PUB TYPE	Guides - Non-Classroom Use (055)
EDRS PRICE	MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS	*Administrator Responsibility; Budgeting; *Committees; *Educational Finance; Expenditures; *Financial Policy; Financial Support; *Governing Boards; Higher Education; Income; Long Range Planning; Operating Expenses; Resource Allocation; *Trustees

ABSTRACT

The responsibilities and functioning of college trustee committees on finance are described. It is noted that the role of the finance committee is to recommend policy for board approval, interpret it to the administration, and to monitor the results. The following responsibilities of the finance committee are discussed: overseeing current financial operations and results; ensuring that a viable long-range financial plan exists or is being developed; and communicating with and educating the board. The structure and agenda of the committee are also addressed. Recommendations for the finance committee include: the committee should understand the factors that affect the flow of funds from various sources and should modify policy or practice to correct a decreasing flow; expenditures should be monitored; the capital budget and the operating budget should be paired for discussion; special attention should be directed to loan funds, plant, and endowment; and the committee needs to assess the financial consequences of the present course and to develop a parallel long-range financial plan. Five reference documents are identified. (SW)

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Finance Committee

John W. Pocock

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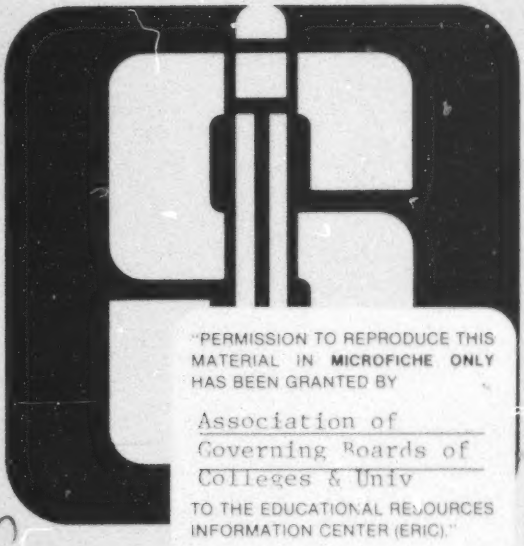

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AGB Standing Committee Series

This publication is part of a new AGB series devoted to strengthening the role of key standing committees of boards of trustees and regents. Several assumptions underpin the series:

- The real work of the boards should be accomplished in committee. An effective committee system will enhance the productivity of full board meetings.
- The committee structure of any board should mirror the full range of its responsibilities as a legal, corporate entity. That is, the committee organization should cover the oversight roles trustees are expected to fulfill.
- Although there is no optimum committee system, certain principles and procedural matters should prevail: A clear and comprehensive statement of responsibility for each standing committee should appear in the board's bylaws or other operating policy. Each committee should be staffed by an appropriate administrative officer with a trustee or regent as chairperson. No trustee should serve on more than two active committees, preferably one—not including an executive committee membership. Crisp, well-conceived meeting agendas together with background information bearing on the agenda should be provided each member in advance of scheduled meetings. The committee's chairperson and staff should work together to ensure that adequate information is prepared to support the business at hand.
- Committees have the responsibility of *recommending* decisions and courses of action to the full board.

As committee members seek more and more useful information in their areas of responsibility, it is important that a balance be struck between "too much" and "too little." It is incumbent on the committee, therefore, to be reasonable

and judicious in requesting information that may be too detailed in order to avoid even the appearance of becoming embroiled in administration. Perhaps all such requests should require an affirmative response to the question: Does this request contribute to the committee's and the board's responsibilities for reviewing, setting, or approving institutional policies?

The AGB Standing Committee Series will eventually include a separate publication for each of the following committees: buildings and grounds, academic affairs, student affairs, development, nominating, and executive. Other committees will be added to the series in due course. The authors of these publications strive to stimulate committee members' resolve that their collective work will reflect favorably on the board's performance as a whole. They share the conviction that committees should, together with their chief executive, set aside time to reflect on their responsibilities, staff requirements, meeting agendas, and follow-up.

AGB and the authors welcome comments and suggestions for improving this publication, and the others in the series, in future editions.

Finance Committee

John W. Pocock

John W. Pocock is chairman of the board of trustees of The College of Wooster, in Ohio. He was a member of the board of directors of the Association of Governing Boards from 1971 to 1980, and now serves as an honorary member of that board. Mr. Pocock was formerly president and chief executive officer of Booz, Allen Applied Research, Inc.

This publication is based on a presentation to the 1982 AGB National Conference on Trusteeship, held in Denver, Colorado.

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Committee Charge

The role of the finance committee is to recommend policy for board approval, interpret it to the administration, then monitor the results. It is not the committee's role to intrude upon day-to-day administrative decisions and bookkeeping.

Finance committees of public and independent institutions share many of the same responsibilities. Although tax-supported institutions receive substantial funding through the legislative appropriation process—therefore are subject to somewhat different requirements and constraints—public finance committees, in line with their counterparts in the private sector, have important responsibilities for overseeing institutional budgets. The major difference concerns the need for greater attention to monitoring the legislative climate as well as the financial climate.

The attempt here is to focus on those generic oversight roles of the finance committee of a board of trustees in both sectors of higher education.

The custody of a college or university's financial well-being is the responsibility of the entire board of trustees. Every member of that board has not only the board responsibility but an individual fiduciary responsibility for the financial affairs of the institution.

The finance committee is only an arm of the board. It has certain responsibilities delegated by the board, for reasons of presumed executive efficiency and expertise. But it is not a subboard living a life of its own, with the ability to make autonomous decisions. Many finance committees do follow this

somewhat independent pattern of operations, to the great disservice of themselves and the entire board.

The finance committee is in a central position relative to the other committees of the board, for every program it deals with has some financial connotation. The academic affairs committee, with its interest in faculty compensation; the buildings and grounds committee, with its desire to improve the maintenance of the campus—both have to get through to the finance committee, which reviews the tradeoffs, sets the priorities, assesses the financial feasibility of the proposals, then presents its recommendations to the entire board.

There must be a continuing dialogue between the finance committee and the administration, probably more so than that required by other committees of the board. There is no substitute for direct, almost immediate exchange between the committee and appropriate members of the administration, sanctioned, of course, by the president and the board chairperson. In fact, the president, the board chairperson, the chairperson of the finance committee, and the vice president for finance will probably be in consultation many times during the year, communicating by phone and meeting as a group.

Structure

The standard pattern of selecting members for the finance committee has been to post those trustees with presumed financial experience and acumen to the committee and just leave them there. There are, however, other attributes that could strengthen the committee's membership. A few "nonfinancial" trustees should serve on the committee, for two reasons.

First, they bring a different viewpoint to financial deliberations; they may stimulate a broader discussion of decisions because their interests are not overly focused on the dollar.

Second, with suitable rotation, nonfinancial trustees can pick up an appreciation of financial issues, with all the counter pressures and tradeoffs, that cannot be gained by simply hearing the finance committee's report to the board.

The continuity required by the finance committee recommends a cautious approach to over-rapid rotation of membership. The pattern of many successful committees has been simply to have a core of more experienced financial types who remain on the committee for a number of years, with much more frequent on-and-off rotation by members whose main interest and experience lie in areas other than finance.

With this type of rotation the appropriate size for the finance committee is slightly larger than that of other board committees. On a private college board of, say, 30 members, the minimum probably would be seven. On a larger board, nine might be the preferred number, although some of those committee members might do double duty as members of other committees.

The boards of public institutions are much smaller and cannot easily accommodate a large finance committee. Some committees may have as few as three members. Given the central importance of financial issues, the full board often may sit as a "committee of the whole." In these sessions the finance committee, which has identified the major issues, examined the causal elements, and developed feasible courses for corrective action, may lead the deliberations.

Agenda

The committee's agenda for the board will vary depending on the particular concerns of the institution. Issues such as the status of the budget cycle, three-year financial projections, capital projects, and investment results all need to be discussed with the full board. Whatever the exact nature of the agenda, the critical point is that the report reflect the committee's deliberations and conclusions, not solely the views of the administration.

It is a tempting convenience to ask the chief financial officer to "just stand up and tell us all about it." Nevertheless, this report is the committee chairperson's responsibility. It reassures the other trustees that indeed their fellows, not content with merely receiving reports from the administration, are fulfilling their delegated duties. The report also reinforces the requirement that the chairperson get behind the numbers to truly understand what they are saying in the broader context of the institution's life, and then be able to relay this to the board. Coming from the chairperson, the committee report is much more likely to be in language easily understood by the nonfinancial trustee.

Responsibilities

The responsibilities of the finance committee fall into three broad areas:

1. *overseeing current financial operations and results;*
2. *ensuring that a viable long-range financial plan is in place or is being developed;*
3. *communicating with and educating the board.*

Responsibility #1: Overseeing current operations

Dollars move through the institution in a continuous flow. Funds acquired from various sources flow through an allocation point and then are expended for salaries, materials, maintenance, and supplies. Some are put aside and invested in the future of the enterprise in the form of buildings, loan funds, endowment, and the like.

It is the finance committee's responsibility to (a) monitor this flow of funds, gauge the flow at selected points, and ensure its compliance with expectations or (b) take corrective action if the flow deviates from the plan or perceived needs.

The funds come from various sources: tuition, fees, government grants (and appropriations, in case of public institutions), services, donations, endowment income. Each institution has its own mix and balance of funds from these sources.

The finance committee needs to understand all the factors that affect the flow from each source. They need to spot trends in the mix and balance between sources and recommend modification of policy or practice that may work to correct the faltering flow.

If endowment total return drops from 12 percent of total funds to nine percent, something important has happened. The investment practices must be sharpened or renewed emphasis must be placed on long-term fund raising, or both. If income from sales and services slackens, the institution may have a quality problem or a marketing task to rebuild that income.

This is not to claim that recognizing these trends in the balance and shift of incoming funds is tantamount to achieving correction. But if the problems

are recognized early on, there is a much better chance that decisions, both short- and long-term, will at least tend to be corrective.

Every member of the finance committee should have in his or her notebook the information that gives the trends and the amount of income from all these sources for the last five years or so. The committee should take time to analyze the information and share the findings with the entire board. Members can then begin to consider how more beneficial patterns can be retrieved or inititated and can balance the tradeoffs. It is here the work of the finance committee starts.

The next step in the flow is monitoring the expenditures. By and large, once the funds are on hand, from whatever sources, finance committees seem to do a pretty good job of watching them flow out—though not necessarily doing anything about it.

Most institutions have their budget cycle fairly well established. It is driven by the need to get at least a broad budget out early enough for tuitions and fees to be announced at the appropriate time, or by the need to establish general faculty salary levels before the contract renewal date.

The detailed budget is developed by the administration. It usually is laid out meticulously in an array of lines and columns, with decimal-point precision, conferring a certain pseudoauthenticity that belies the assumptions, tradeoffs, bargaining, gap-filling, log-rolling, and wild hopes it incorporates. But good, bad, or indifferent, the budget at least gives the finance committee a comforting benchmark to compare with actual expenditures.

With regard to this budget process the finance committee should be guided by three main admonitions. The first has to

do with the assumptions on which the budget is based. The administration will have spelled out the assumptions in detail and sought concurrence from the finance committee—or at least should have. But too often the finance committee's acceptance is cursory if not completely automatic. However, budgets are creatures of their basic assumptions. In these financially awkward days for higher education, the budget developers, driven by wis ful yearnings, frequently tend toward the "hoped-fors" in their assumptions rather than the "most-likelies," and shy away from the worst cases.

This is not referring to such things as the assumed rate of inflation and general economic conditions, where budget makers and finance committees can only compete with the economic soothsayers. Rather, the assumptions in question concern the size of the incoming class, retention rate, the incremental costs of new programs yet to be established in detail, the rate of incoming gifts, and so forth. These are matters about which the finance committee should have some knowledge. The assumptions should be laid out from best case to worst case if the committee is to exercise its responsibility for prudent management.

A second admonition has to do with funding priorities and major allocations. A favorite point in the list of responsibilities of the finance committee reads something like this: "Allocate available funds in line with established program priorities." That's a simple, precise statement, but what does it mean operationally?

Of course, some elegant computer models will balance available funds against decimal-sequenced priorities and come out with an optimum budget. But real life is not so automatically ordered. More likely the finance

committee will use whatever information it can get from all sources and then try to nudge the funds in the direction of those u es expected to contribute most to the institution in the years ahead.

This is not a limited computer exercise. It is a judgment far more intuitive than a lot of our theorists may care to admit. But the job of the finance committee is to make such judgments and the ensuing allocations.

The third admonition has to do with the capital budget. Most finance committees deal first with the operating requirements of today and, if no catastrophe looms, then allocate whatever monies may be left to future capital projects. The task of allocating between present and future needs—capital needs, for the most part—is perhaps the most difficult task facing the finance committee and, indeed, the board as a whole.

A capital budget should be paired with the operating budget for discussion, tradeoff analysis, and approval by the finance committee and the board. Capital expenditures require as much planning, budgeting, and monitoring as do the operating requirements, and the finance committee is the agency to insist upon a budget.

Three areas of the budget deserve special attention: loan funds, plant, and endowment.

It is no news to most trustees who have read the headlines in the last two years that stewardship of loan funds has generally been poor to scandalous. With government support beginning to recede many institutions in the private sector will increasingly find reason to consider, for example, shifting some endowment or quasi-endowment to student aid and, perhaps, building up the student aid fund.

However, regardless of the sanctity of

any program designed to help students get their education, there is still a business and financial side to it. There is going to be understandable pressure for low interest rates, loan risks beyond those normally deemed acceptable, and as a result the subsequent losses will be higher. It is up to the finance committee to understand these tradeoffs and monitor the administration of loan funds more closely than has been done in the past.

Investment in physical plant is another sore spot. As many recent studies have pointed out, higher education plants have been undermaintained for years. Some estimates have put the arrears at ten or more years, with perhaps as much as $4 billion in deferred maintenance liabilities.

Colleges and universities have been gnawing away at their capital base for so long that today the roof may be ready to collapse, both literally and figuratively. It is the finance committee's responsibility to begin to reestablish the institution's capital base.

The finance committee also oversees endowment, if endowment exists, and should have policies and guidelines in place concerning investment practices. Often committees assume that "general consensus," "common practice," and the "shared attitudes" of members constitute an investment policy. Policies and guidelines exist only when they are written down and have been shared with and concurred on by the entire board.

Responsibility #2: Long-range financial planning

Many finance committees are guilty of neglecting the long view. Because everyone likes to see black figures at the bottom line of the operating statement, accounting guidelines are flexible

enough so that some honest accounting artistry can bring the figures into some sort of cosmetic balance. But it is the finance committee's responsibility to see through those cosmetics and understand what really is going on, determining what is needed for the long-term health of the institution and developing plans for those future needs.

Since this kind of planning can pit the present against the future, it must rely on an institutional long-range projection that allows the finance committee to assess the financial consequences of the present course and to lay in a parallel long-range financial plan. If the institution does not have a long-range plan, the finance committee may be the place to urge the board to bring such a plan into being, because it is needed for financial planning.

Responsibility #3: Communication and education

The finance committee will spend many hours working on the details of its charge. Much of that detail is never reported to the board, nor should it be. The main purpose of the committee structure is to relieve the whole board of the requirement to get into detailed discussion on these matters.

But all the basic issues should be brought to the entire board for discussion bereft of jargon and in a manner readily understood. Pros and cons, potential results of decisions, committee recommendations—all this should be spelled out by the finance committee for the edification of the board.

Another effective education tool, as discussed earlier, is the rotation of "nonfinancial" trustees on and off the finance committee. These board members will acquire a good grounding

in financial issues that they can share with their fellow trustees as they move on to various committees.

Conclusion

Having accepted the responsibilities for policy direction and monitoring of financial matters on behalf of the entire board, it is axiomatic that the finance committee should regularly assess its own performance. Its members periodically should ask themselves such questions as: Are we asking for the right information in the best formats? Are we consulting on important policy matters with other committees and the board itself? What should we do to strengthen the committee's effectiveness?

The finance committee does not function in a vacuum. Its activity has links with the administration and, through them, to all the institutional constituencies. The effectiveness of this linkage is all-important. It is the proverbial team effort; and if the overall financial report card of the institution reads poorly, a great deal of the blame has to be borne by the finance committee. If the financial report card has high marks, the committee probably has done its job well.

In the last analysis, the stewardship of the finance committee must stand the test of time: the existence of a healthy institution. This is proof that the committee's performance today serves the needs of tomorrow.

Resources

The Cost of Higher Education, by Howard R. Bowen (San Francisco: Jossey-Bass, 1980). An excellent treatise on the economics of higher education by one of the most respected scholars in the field. Provides a background for understanding the broader context of institutional financial decisions.

Financial Responsibilities of Governing Boards, by the Association of Governing Boards (Washington, DC: AGB, 1979). An overall exposition of financial planning and monitoring, stressing the interplay of financial matters with all elements of the institutional program.

Handbook of College and University Trusteeship, by Richard T. Ingram and Associates (San Francisco: Jossey-Bass, 1980). Chapters 15 and 16 provide an easy-to-read discussion of budget building, financial monitoring and reporting, allocation, and management of resources.

Hang Gliding or Looking for an Updraft, by Hans H. Jenney (Wooster, OH: College of Wooster and John Minter Associates, 1981). Subtitled "A Study of College and University Finance in the 1980s—The Capital Margin." A provocative and innovative review of the nature of capital erosion in our institutions, with suggestions of courses of action for replacement and renewal.

NACUBO Writers on Financial Management, (Washington, DC: NACUBO, 1983). A rich compilation of well-chosen articles from *Business Officer*, the monthly publication of the National Association of College and University Business Officers. The articles are by experts in their fields and cover the entire spectrum of financial planning and management. Perhaps the best current source of "how to do it."

AGB Standing Committee Series

This is the third in a series of publications on the key standing committees of the board of trustees. These concise, pocket-size publications are designed to provide important information on committee issues and operations for every member of the board. Other titles published or planned are:

Buildings and Grounds Committee
Harvey H. Kaiser

Academic Affairs Committee
Richard P. Chait and Barbara Taylor

Development Committee
William A. Kinnison

Student Affairs Committee
Thomas G. Goodale

Executive Committee
Richard T. Ingram

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